APAC Agricultural Policy Analysis Center
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PolicyPennings by Dr. Daryll E. Ray

WTO panel identifies problem, but will their implied solution work?

One of the major factors that casts a long shadow over discussions of the 2007 Farm Bill is the Brazilian cotton case. Beginning in 2002 Brazil began the process of challenging the US cotton program arguing that the subsidies it provides to US producers were prohibited under WTO rules and had an adverse impact on Brazilian cotton farmers. The gist of the argument against the US program was that the subsidies stimulated US cotton farmers to produce more cotton than they would have in the absence of subsidies, increasing the surplus and reducing the price of cotton.

This case is important to farm bill discussions because some of the conclusions the Disputes Panel reached are applicable to other US crops as well, particularly corn, soybeans and wheat. The panel ruled that direct payments (fixed decoupled payments) cannot be considered to be in the green box (non-trade-distorting) because of the fruit and vegetable planting restriction. In addition the marketing loan payments – Loan Deficiency Payments (LDPs) and Marketing Loan Gains (MLGs) – and the counter-cyclical payments (CCPs) were ruled as suppressing the price of cotton.

Since those rulings there has been considerable speculation whether or not one or more countries might challenge the US corn, soybean, and wheat program on this same basis because these programs are in effect for those three crops as well. The arguments that other countries might use have been made available on the internet. This led us to look at what we might say if we were asked to provide expert testimony in such a case.

The underlying premise behind possible challenge to the US corn, soybean and wheat programs is that US subsidies have stimulated US farmers to produce more corn, soybeans, and wheat than they would have produced in the absence of subsidies. As a result of this extra production, it is argued that prices since 2000 are lower than they would have been in the absence of subsidies. Reduced to the simplest of terms the premise is that US subsidies have caused low prices for these three commodities.

The problem with this line of reasoning is that the high level of US subsidies is the result of low prices not the cause of low prices. It was the low prices of the 1998 crop year that stimulated US producers to lobby Congress for aid. This assistance was provided in the form of emergency payments. In the 2002 Farm bill these emergency payments – made for the 1998-2001 crop years – were institutionalized in CCPs. From a historical perspective, the high payments were the result of low prices not the cause of low prices.

Thus, when one investigates the connection between subsidies and planting levels in the US, one must also examine the strong likelihood that other factors may have a more significant impact on US production levels than subsidy levels and critics of US farm programs are loathe to look at these other factors. It is not that eliminating subsidies would not have an effect. It would. Land prices would decline. This in turn would trigger a large set of unpleasant impacts. The questionable part is: How much will US production decline and prices increase.

To really understand low prices, the WTO Disputes Panel needs to understand that food consumers respond to changes in food prices the way a diabetic responds to changes in the price of insulin – very little. Similarly, over a wide range of prices, farmers plant crops on all of their crop acres every year. In addition, farmland has few alternative uses and when acres are converted to subdivisions and malls, they cannot be recovered for crop production when higher prices return. Farmers may exit farming, but, on the whole, farmland remains in production.

The problem we have with most analyses of US agriculture and WTO compliance issues is that they fail to take into account the underlying characteristics of crop production and food consumption. We are not arguing that one should not look at the relationship between production levels and subsidies, but rather that one look at this relationship in the context of the underlying characteristics of crop production and food consumption. To look at subsidies isolated from these characteristics is like straining at gnats while swallowing camels.

If the reason that other countries are challenging US farm policies is low prices, then it does no good to come to policy conclusions that when implemented will not raise farm commodity prices in the US and elsewhere.

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